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IN THE MATTER OF THE GENERIC  
PROCEEDINGS CONCERNING ELECTRIC  
RESTRUCTURING ISSUES

~~Docket No. E-00000A-02-00517~~

IN THE MATTER OF ARIZONA PUBLIC  
SERVICE COMPANY'S REQUEST FOR A  
VARIANCE OF CERTAIN REQUIREMENTS OF  
A.A.C. R14-2-1606

Docket No. E-01345A-01-0822

IN THE MATTER OF THE GENERIC  
PROCEEDING CONCERNING THE ARIZONA  
INDEPENDENT SCHEDULING  
ADMINISTRATOR

Docket No. E-00000A-01-0630

IN THE MATTER OF TUCSON ELECTRIC  
POWER COMPANY'S APPLICATION FOR A  
VARIANCE OF CERTAIN ELECTRIC  
COMPETITION RULES COMPLIANCE DATES

Docket No. E-01933A-02-0069

IN THE MATTER OF THE APPLICATION OF  
TUCSON ELECTRIC POWER COMPANY FOR  
APPROVAL OF ITS STRANDED COST  
RECOVERY

Docket No. E-01933A-98-0471

STAFF'S NOTICE OF FILING  
WITNESS SUMMARIES

Staff hereby provides its Notice of Filing Witness Summaries of Matthew Rowell, Erinn  
Andreasen, Barbara Keene, Jerry D. Smith, David A. Schlissel, Neil H. Talbot and Paul R. Peterson.

RESPECTFULLY SUBMITTED this 18th day of June, 2002.

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1 Original and ten copies of the foregoing  
2 filed this 18th day of June, 2002,  
3 with:

4 Docket Control  
5 Arizona Corporation Commission  
6 1200 West Washington  
7 Phoenix, AZ 85007

8 Copy of the foregoing mailed this 18th  
9 day of June, 2002, to:

10 All parties of record

11 Nancy Roe

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**GENERIC PROCEEDINGS**  
**CONCERNING ELECTRIC RESTRUCTURING ISSUES**  
**Docket No. E-00000A-02-0051, et. al**  
**Summary of Matthew Rowell**

My testimony describes Staff's recommendations. Staff's recommendations are:

1. Prior to the transfer of any generation assets, the utilities should be required to file a market power study and market power mitigation plan for Commission approval.
2. Generation assets identified as must-run units may only be transferred subsequent to the Commission's consideration of their must-run status.
3. Other generating units can be transferred at the utilities' discretion.
4. The recommendations concerning codes of conduct outlined in Barbara Keene's testimony should be implemented prior to transferring the assets.
5. Transfer of generating assets should not be required of the utilities.
6. For utilities that choose to transfer their generation assets to an affiliate, the cost of service of those assets along with market prices should be considered during prudence evaluations of procurement practices for retail ratemaking purposes. Cost of service considerations should not be applied when evaluating the prudence of power purchases by a UDC to serve load that is beyond the utilities' current capacity to supply.

**GENERIC PROCEEDINGS**  
**CONCERNING ELECTRIC RESTRUCTURING ISSUES**  
**Docket No. E-00000A-02-0051, et. al**  
**Summary of Erinn Andreasen**

Through its ordinary duties, Commission Staff communicates with industry participants and monitors the industry in an informal manner. However, a more formal approach toward facilitating communication and information sharing has not been established. Therefore, I recommend that the Commission form an Electric Competition Advisory Group for purposes of facilitating communication and the sharing of information among Staff, stakeholders, and market participants about wholesale and retail market transactions, market structures, and impediments to competition.

**GENERIC PROCEEDINGS  
CONCERNING ELECTRIC RESTRUCTURING ISSUES  
Docket No. E-00000A-02-0051, et. al  
Summary of Barbara Keene**

My testimony is concerned with affiliate relationships. My recommendations are in regard to the need for a new code of conduct between affiliates.

The major recommendations of my direct testimony are:

1. Any investor-owned utility that wants to purchase power from an affiliate within 12 months of a Commission Decision in this docket must file a code of conduct for Commission approval within 90 days of a Commission Decision in this docket.
2. Any investor-owned utility that has already purchased power from an affiliate must file a code of conduct for Commission approval within 90 days of a Commission Decision in this docket.
3. Any investor-owned utility that has not made a filing in response to nos. 1 or 2 above but in the future plans to purchase power from an affiliate must obtain Commission approval of a code of conduct before executing any affiliate transactions.
4. Prior to a transfer of generation assets to an affiliate, an investor-owned utility must file a code of conduct for Commission approval unless such code of conduct has already been filed in response to recommendations nos. 1, 2, or 3 above.
5. The code of conduct should cover an investor-owned electric utility regulated by the Commission and all affiliates from which the utility may purchase power or which are in energy-related fields.
6. The code of conduct should address, at a minimum, arm's-length transactions; access to confidential information; cross-subsidization; preferential treatment to affiliates; joint employment and employee transfer issues; sharing of office space, equipment, and services; proprietary customer information; financing arrangements with affiliates; and conflict of interest.
7. In particular, Staff recommends that transactions between affiliates be at arm's length, with the same representative not appearing on both sides of a transaction.

**GENERIC PROCEEDINGS**  
**CONCERNING ELECTRIC RESTRUCTURING ISSUES**  
**Docket No. E-00000A-02-0051, et. al**  
**Summary of Jerry D. Smith**

**Direct Testimony**

Mr. Smith's direct testimony concludes that generation and transmission in Arizona is presently inadequate to ensure reliable service to the consumers of Arizona. Utilities are presently dependent upon use of reliability must-run generation and load tripping schemes to meet local load requirements due to local transmission import constraints. Transmission and natural gas pipeline capacity also pose barriers to development of a competitive supply margin with new generators.

The generation developing in Arizona may be sufficient to establish a competitive supply margin once transmission reliability constraints are resolved and new gas pipeline capacity is constructed. New transmission solutions are beginning to emerge in the ten-year plans being filed with the Commission. However, considerably more planning is required to ensure sufficient transmission is in place to provide reliable service to Arizona at just and reasonable rates via a competitive wholesale market.

Mr. Smith recommends a variety of actions in this testimony. These actions are collectively intended to accelerate development of transmission solutions in Arizona for reliability purposes. These recommendations will also facilitate restructuring of the electric industry to reliably serve consumers at just and reasonable rates via a competitive wholesale market at the earliest possible date. Staff's recommendations include an industry-wide collaborative planning process engaging all sectors of the electric utility industry to resolve local transmission import constraints and transmission constraints prevailing at plant interconnections with the transmission grid.

**Rebuttal Testimony**

Mr. Smith's rebuttal testimony deals exclusively with transmission and transmission service issues. His first conclusion is that others support Staff's view that local transmission constraints need to be resolved. Transmission improvements are needed to resolve Staff's reliability concerns, avoid vertical market power associated with transmission, and facilitate the emergence of a competitive wholesale market and retail competition. The need for mitigating transmission related vertical market power complements and supports Mr. Smith's direct testimony that expedient resolution of transmission constraints is paramount to ensuring reliable service to consumers at just and reasonable rates.

Secondly, Mr. Smith concludes from other's testimony that established market power tests fail to adequately address transmission constraints. Furthermore, FERC's solutions to transmission market power are not likely to address local transmission constraints. Therefore, Mr. Smith recommends adoption and compliance with the two reliability principles proposed in his direct testimony as the best means for eventual elimination of local transmission constraints.<sup>1</sup> Such action will consequently mitigate local transmission market power.

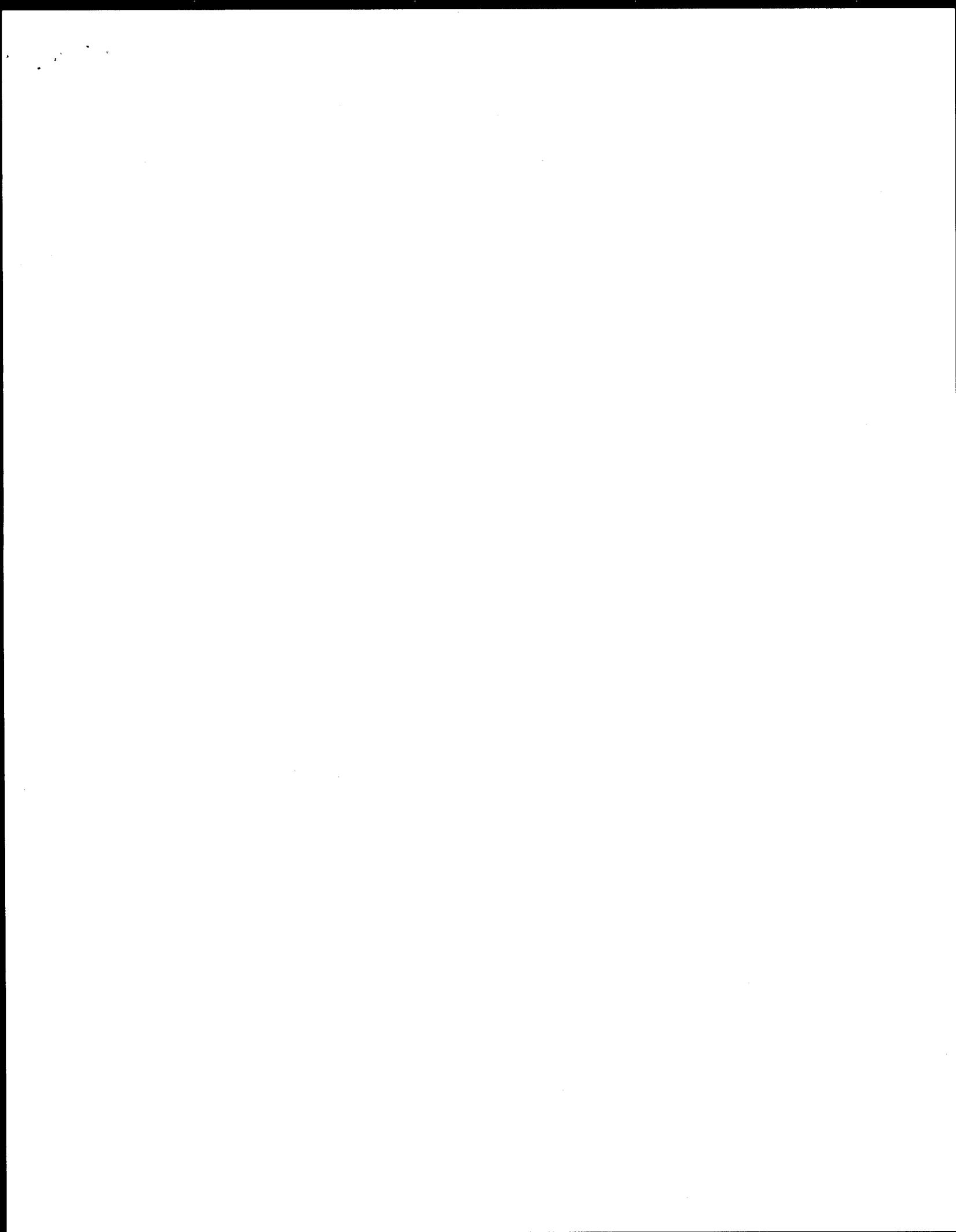
Thirdly, Staff concludes that reliance on the AISA and Westconnect protocols as the sole mitigation measures for RMR generation requirements caused by local transmission import

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<sup>1</sup> Jerry D. Smith, at lines10-16, page 25.

constraints is not in the public's interest. The protocols are effective operational tools for managing RMR generation requirements but were never designed nor intended as market power mitigation measures. Staff recommends three actions to mitigate RMR generation including constructing needed transmission facilities as soon as practical if the Commission finds a UDC's RMR generation strategy to not be in consumers' best interest.

The final conclusion of Mr. Smith's rebuttal testimony is that the proper and non-discriminatory designation of power plants as Network Resources and use of available transmission capacity for network transmission service is critical to emergence of a competitive wholesale market in Arizona. While the FERC proposed Energy Resource Interconnection Service and Network Resource Interconnection Service may be in the best interest of generators, they may not be in the best interest of Arizona's consumers. Therefore Staff endorsement of proposed power plant interconnections is contingent upon resolution of any transmission delivery problems associated with the interconnection. Once again, adoption of and compliance with the two reliability principles proposed in Mr. Smith's direct testimony offers the best means of ensuring a merchant's delivery of power to local markets.



**GENERIC PROCEEDINGS  
CONCERNING ELECTRIC RETRUCTURING ISSUES  
Docket No. E-00000A-02-0051, et. al  
Summary of David A. Schlissel**

**Direct Testimony**

Mr. Schlissel was asked by the ACC Staff to examine whether the transfer and separation of generating assets by the Arizona Public Service Company ("APS") and/or the Tucson Electric Power Company ("TEP") will create market power issues.

Mr. Schlissel's direct testimony concludes that as a result of the transfer and separation of its generating assets APS and its affiliates would be able to exercise market power, most significantly in the transmission constrained areas in the Phoenix Valley and Yuma. Mr. Schlissel similarly concluded that as a result of the transfer and separation of its generating assets, the TEP and its affiliates would be able to exercise market power in the Tucson load constrained area which contains all of the Company's retail loads.

For these reasons, Mr. Schlissel recommended that APS and TEP should be required to present detailed analyses of the potential for the exercise of market power before the Commission grants approval for the transfer and separation of their generating assets to affiliates.

**Rebuttal Testimony**

Mr. Schlissel's rebuttal testimony addresses several points made in the testimony filed by APS witness William Hieronymus and Panda Gila River witness Craig Roach.

In particular, Mr. Schlissel explains that the application of FERC's new SMA test to the APS control area by APS witness Hieronymus does not present a meaningful result because it fails to reflect the transmission system constraints that severely limit the amount of capacity that can be imported into the Phoenix Valley and Yuma load pockets. Mr. Schlissel also concludes that the Commission should not give any weight to Mr. Hieronymus's conclusion that APS would not be able to exercise market power in the larger western markets because even though APS may not be able to exercise market power in the larger western markets, it will be able to exercise market power in the Phoenix Valley and Yuma load pockets which together represent more than 2/3 of its retail load in Arizona.

Mr. Schlissel also disagrees with the claim by APS witness Hieronymus that "the most obvious means of dealing with potential market power is to require that the supplier dedicate a portion of its capacity to a long-term contract. In support of this conclusion, Mr. Schlissel presented the long-term contracts signed by the State of California during the height of its energy crisis as examples of contracts that "locked-in" purchasers to paying higher than competitive prices over long periods of time.

Finally, Mr. Schlissel notes his agreement with the conclusions of Panda Gila River witness Roach that (a) APS has generation and transmission market power; (b) if APS is allowed to unconditionally transfer its generation facilities to an Affiliate, it will also be transferring its market power to that Affiliate; and (c) because the Commission will have less authority after the transfer to prevent harm to consumers from the exercise of market power by that Affiliate, it must ensure that, prior to such transfer, APS' market power will be mitigated.

**GENERIC PROCEEDINGS  
CONCERNING ELECTRIC RESTRUCTURING ISSUES  
Docket No. E-00000A-02-0051, et. al  
Summary of Neil H. Talbot**

**Direct Testimony**

On the issue of market power in regional and local power markets, Mr. Talbot suggests that there should be a *rebuttable presumption* that incumbent utilities and their affiliates have both horizontal and vertical market power when they restructure. Mr. Talbot proposes that as a threshold requirement, *before its generation assets are transferred or divested*, each utility should be required to demonstrate that after transfer or divestiture the wholesale electricity market will be reasonable competitive and well-regulated.

To the extent that market power concerns are identified, a utility should present a *mitigation plan* to the Commission. It seems clear, for example, that transmission systems in Arizona need to be enhanced, and that the regional power market needs to be better monitored by appropriate regional institutions such as an RTO, under the aegis of FERC.

On the issue of *jurisdiction*, the transfer of generation assets to an affiliate, or the divestiture of generation assets to a non-affiliated company, will result in a loss of jurisdiction by the Commission. Mr. Talbot argues, however, that the Commission retains the authority to ensure that the retail rates of a utility or UDC are just and reasonable. Correspondingly, the utility or UDC retains or should retain control over the acquisition of electricity for Standard Offer customers.

**Rebuttal Testimony**

Mr. Talbot's rebuttal testimony seeks to find a middle ground on the issue of competitive markets. On the one hand, he does not agree with Mr. Higgins's apparent view that FERC can be relied upon to deal with wholesale market problems in a timely fashion. On the other hand, he does not share Dr. Rosen's extreme skepticism about FERC.

Mr. Talbot shares Mr. Pignatelli's optimism that the wholesale electricity market can become reasonably competitive. But, as Mr. Pignatelli says, "the art of balancing regional supply and demand without a regulatory mandate and delivery infrastructure issues must be addressed." (Direct Testimony, page 12)

Mr. Talbot agrees with Dr. Roach's recommendation that, before assets are transferred or divested out of the Commission's jurisdiction, market power mitigation plans should be in place. However, on the issue of competitive procurement of power by UDCs, he does not agree with Dr. Roach that a UDC should only be allowed to transfer

its assets if it competitively procures 100% of the power it needs for Standard Offer customers.

Regarding the testimony of APS witnesses Mr. Davis and Dr. Hieronymus, Mr. Talbot's reading of the Electric Competition Rules and the Settlement Agreements is that transfer or divestiture of generation is coupled with competitive bidding for generation by the UDC. The expectation that electricity markets would be fully competitive by this time has not been realized, as APS itself argued so cogently in its Application for a Variance of Certain Requirements of A.A.C. R14-2-1606. Accordingly, it is appropriate for the Commission to reconsider asset transfer along with competitive bidding.



**GENERIC PROCEEDINGS  
CONCERNING ELECTRIC RESTRUCTURING ISSUES  
Docket No. E-00000A-02-0051, et. al  
Summary of Paul H. Peterson**

**Direct Testimony**

Mr. Peterson's direct testimony identifies critical structures and rules that are necessary to minimize market manipulation and the exercise of market power in restructured electric markets. Although problems in California's wholesale markets have garnered most of the headlines, Mr. Peterson discusses the significant problems that have been experienced in the New York, New England, and PJM markets due to market design flaws and the abusive behaviors of market participants. He also explains that the consequences of many of these behaviors have been unreasonably high wholesale market prices that can translate into higher costs for consumers.

Mr. Peterson consequently recommends that the Commission proceed cautiously with restructuring in Arizona in light of the significant problems that have been experienced in competitive, bid-based wholesale markets around the country. Until specific structures such as RTOs and well-designed markets that are subject to appropriate monitoring and mitigation oversight are established and are demonstrated to be effective, Arizona electricity consumers will be exposed to the risk of market manipulation, abuse, and gaming that may lead to requests for sudden and dramatic increases in retail electricity prices. Under current market models, the Commission will have little immediate recourse other than to grant the price increases, and then petition the FERC for prospective changes to avoid future high prices. Mr. Peterson's testimony also supports Staff's general recommendation that if APS is confident that the transfer of its assets is the best course of action at this time, then it is appropriate to assign to APS the financial risks associated with such a decision.

**Rebuttal Testimony**

Mr. Peterson's rebuttal testimony responds to portions of the Direct testimony of Arizonans for Electric Choice and Competition ("AECC") witness Higgins and Arizona Public Service Company ("APS") witnesses Davis and Hieronymus.

Mr. Peterson explains in his rebuttal testimony that based on FERC's poor performance to date, he does not share the optimism and confidence of AECC witness Higgins in the FERC's ability to develop and implement appropriate wholesale market structures. He also explains the reasons why he disagrees with the argument of APS witness Davis that the decisions formulated in 1998 and 1999 regarding the divestiture of generation assets should be strictly adhered to without reconsideration in light of subsequent events. Mr. Peterson explains that, to the contrary, he believes that the Commission has a responsibility to make the best decision it can today, based on current information, to protect the interests of Arizonans even if that means that the Commission should re-examine in light of subsequent events the decision to require a transfer of generation assets.

Mr. Peterson's rebuttal testimony also disagrees with the claim by APS witness that the electricity crisis recently experienced in California was solely the result of that state's particular market rules and history. Instead, as Mr. Peterson explains, all bid-based wholesale markets have experienced problems with market design flaws and short-term imbalances between demand and supply that have been exploited by market participants to raise prices above competitive levels. In fact, as Mr. Peterson explains in his rebuttal testimony, the FERC has been just as slow to address problems in the Northeast wholesale markets as it was in California.

Finally, Mr. Peterson recommends in his rebuttal testimony that the Commission make sure that either the structural elements or appropriate rules are in place at the wholesale level before it makes any irrevocable decisions regarding the transfer of utility generation assets. He further recommends that before it allow the transfer of generation assets, the Commission require market power analyses based on tests that account for the unique attributes of wholesale and retail electric systems.